

TEACHERS' RETIREMENT BOARD  
BUDGETS AND AUDITS COMMITTEE

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SUBJECT: Inactive Member Accounts Audit

ITEM NUMBER: 8

ATTACHMENTS: \_\_\_\_\_

ACTION: \_\_\_\_\_

DATE OF MEETING: April 6, 2000

INFORMATION: X

PRESENTER: Way Lee

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We have completed our audit of refunds made to inactive members and the identification and notification of inactive members during the period from July 1, 1994 through March 31, 1999. We conducted a comprehensive preliminary review of these activities including an analysis of the internal control system. We performed testing of the controls in some of the higher risk areas. Based on the results of our audit, we formed the opinion that internal controls were adequate for us to accomplish the objectives of our audit. However we did identify several issues that require corrective action and we identified areas where the control system could be strengthened to further mitigate risk exposure.

Our recommendations for improvement focused primarily on the refund of pension benefits and the locating and informing of inactive members within the Service Retirements Division of the Client Benefits and Services Branch. These recommendations include developing formal policy and procedures for some activities and the reassignment of incompatible duties.

Our audit findings and recommendations, as well as management's response to the issues, are summarized below within three broad categories i.e., inactive member refunds, the identification and notification of inactive members and the assignment of incompatible duties.

1. **Inactive member refunds:** The Service Retirements Division does not have adequate internal controls to ensure that inactive member refunds are made only to those members entitled to the refund. For example: third party verification of an applicant's identity is not obtained and there is no supervisory level review to ensure that documentation is complete and/or refunds are properly approved prior to the distribution of the pension benefit.

Management should develop policies and procedures regarding the processing of inactive member account refunds. The procedures should include obtaining some form of independent third party identity verification such as a member's driver's license, military identification, passport, and notarized signature. In conjunction with these procedures, management could block inactive member accounts within its information system to prevent the processing of refunds until a high level review is performed. Also, management should consider surveying other similar pension plans concerning their development of policies and procedures. The

survey could include questions regarding the methods they used to obtain reasonable assurance regarding the identity of inactive members and what resources were utilized to locate and inform inactive member of their pension benefits.

**Response:** *Staff concur. Although staff was aware that the existing policies and procedures regarding the processing of member account refunds are consistent with another major retirement system, the procedures should be reviewed and updated. This review will include the need for third party identity verification and assessing the completeness of the application. The analysis will include recommendations based on industry best practices, legal considerations, and levels of risk and liability.*

- 2. Identification and notification:** CalSTRS has not made a good faith effort to periodically locate its inactive members and inform them concerning their pension benefits as required by California Education Code Section 22309(b). The Office of Audits (OOA) estimates that approximately 16,000, or twenty-six percent, of CalSTRS' inactive members do not have a deliverable mailing address. However, CalSTRS has not made a periodic good faith effort to locate and inform them. The last major effort to locate inactive members was in fiscal year 1992-93.

A more aggressive approach by management to contact inactive members, update their retirement account addresses and/or perform death matches should be considered. For example CalSTRS could contact the State Controller's Office, Department of Motor Vehicles, Franchise Tax Board, Federal Bureau of Internal Revenue Service, Social Security Administration, Federal Department of Defense, CalPERS, various credit reporting agencies, and use the Internet to locate living members.

Management could also contact other pension plans to consider how they have defined a "periodic good faith effort" and determine what policies and procedures they developed and what resources were utilized to implement their plan. A good tool to assist management with this task would be a survey. The survey could be developed and conducted to determine industry best practices and specifically address such issues as periodicity and resources deployed. In conjunction with the survey formal policies and procedures should be developed with regard to locating and informing inactive members of their pension benefits and federal minimum distribution requirements on a periodic basis.

- **Response:** *Once a member terminates the employment relationship with the district, CalSTRS loses access to current information. It is CalSTRS' current practice to have the "Inactive Member" assume responsibility for keeping their address current with the System. CalSTRS does encourage members to keep their addresses current through the various publications. There is also a presumption that the Inactive Member is aware that assets are being held on their behalf at CalSTRS.*

*The report correctly cites that the last "major effort" by the System to locate Inactive Members was in fiscal year 1992/93. At that time there were approximately 50,000*

*Inactive Members. To accomplish this, a special unit of approximately five staff was established to process the related workload. It should also be noted that ongoing efforts have been made to locate Inactive Members concerning the 70 ½ year-old distribution issue.*

*As recommended, staff will review and consider its approach to contacting members, the responsibility to update the addresses of Inactive Members and the frequency of performing “death match” searches. Staff further recommends that this effort be reported to the Benefits and Services Committee for its approval. Policies and procedures will be updated to reflect the direction provided by this report.*

3. **Incompatible duties:** A staff member, who had access to inactive member account data, was assigned incompatible duties. Those duties would allow the staff person to initiate a payment document, input payment information and maintain the record file. These assigned duties had not been appropriately updated when the staff member was reassigned to another area of responsibility. Without the proper separation of duties, an employee could conceal errors or irregularities, which may not be detected by management.

Management should ensure that staff members’ access to computer functions is re-evaluated and properly updated when staff are reassigned duties. The approval, input and reconciliation functions should not be assigned to the same individual.

**Response:** *Staff concur. The staff in question was a lead analyst in the “Inactive Unit” during its existence. When the Unit was disbanded, the analyst was reassigned to other responsibilities but also retained some responsibility for “Inactive Member” oversight. Staff concur with the auditor’s recommendation and have realigned the staff’s access to various computer functions.*